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DEC 28 1949

CHARLES ELMORE CROPLEY

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 505

TRANSPORT, TRADING & TERMINAL CORPORATION,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

ARTHUR A. BALLANTINE,
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INDEX.

PAGE

Summary Statement of the Matter Involved 1

Jurisdiction 6

The Opinions of the Courts Below 6

Statutes Involved 6

Facts 8

Decisions Below 10

Questions Presented 13

Reasons Relied on for Allowance of the Writ 14

1. The writ of certiorari should be issued in order that this Court may determine fundamental questions respecting the review of Tax Court decisions, viz.:

   (a) Whether the 1948 amendment of §1141(a) IRC, abrogating the rule of the *Dobson* case, empowered the Court of Appeals to try the case *de novo* on the record, reject the Tax Court's findings of fact and substitute contrary findings of its own; and

   (b) Whether the Court of Appeals could properly reverse the Tax Court, without a remand of the case for further hearing, upon an issue not presented to the Tax Court, viz.: whether the distribution of the Pacific-Atlantic stock should be disregarded on the theory that it did not constitute a "dividend" within the meaning of §115 (a) IRC 14

PAGE

2. The writ of certiorari should be issued to determine whether, as the Court of Appeals held, the rule of the *Gregory* case warrants the disregard of a valid and genuine corporate distribution on the theory that it was made for tax-saving purposes and was therefore not a "dividend" within the meaning of §115(a) IRC..... 20

3. The decision should be reviewed because the action of the court below in disregarding the distribution made by the petitioner conflicts in principle with this Court's decision in *General Utilities & Operating Co.* v. *Helvering*..... 22

Conclusion 25

Citations.

Cases:

	PAGE
Comm'r v. *Court Holding Co.*, 324 U. S. 331 (1945)	2, 10
Cumberland Public Service Co. v. *United States*, 83 F. Supp. 843 (Ct. Cls., 1949) cert. granted Oct. 17, 1949	4
Dobson v. *Commissioner*, 320 U. S. 489 (1943)	15, 16
General Utilities & Operating Co. v. *Helvering*, 296 U. S. 200 (1935)	5, 11, 13, 19, 22, 23, 24, 25
Gregory v. *Helvering*, 293 U. S. 465 (1935)	3, 5, 10, 11, 13 20, 21, 22, 25
Helvering v. *National Grocery Co.*, 304 U. S. 282 (1938)	15, 16
Hormel v. *Helvering*, 312 U. S. 552 (1941)	19
United States v. *Yellow Cab Company*, Oct. Term, 1949, No. 22 (Dec. 5, 1949)	17
Wilmington Trust Co. v. *Helvering*, 316 U. S. 164 (1942)	14, 16

Statutes:

Internal Revenue Code:	
§22	6
§22(a)	19
§22(f)	24
§26(b)	2
§111	6, 24
§115	7
§115(a)	3, 5, 13, 14, 18, 19, 20, 22, 25
§1141(a)	6, 7, 14, 15, 16, 17
§1141(c)(1)	15, 16, 17, 18, 19
Judicial Code, §1254(1) (28 U. S. C. §1254(1))	6

Miscellaneous:

H. R. 3214, 80th Cong.	17
Senate Report No. 1559, 80th Cong., 2nd Sess.	16
Public Law 773, §36 (80th Cong., 2nd Sess.)	7, 15, 17
Rules of Civil Procedure, Rule 52(a)	17, 18

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Summary Statement of the Matter Involved.

Petitioner prays that a writ of certiorari be issued to the United States Court of Appeals for the Second Circuit to review a judgment of that court rendered in the above case on October 4, 1949 (R. 71-72), reversing a decision of the Tax Court of the United States that the petitioner had overpaid its Federal income taxes for the calendar year 1940 in the amount of $167,767.62 (R. 14-15).

Petitioner submits that the Court of Appeals committed far-reaching errors of law which, if not corrected by this Court, will affect thousands of transactions and produce a mass of tax litigation.

The case arises out of a sale of certain stock by American-Hawaiian Steamship Company, parent of petitioner, under the following circumstances. On October 25, 1940, petitioner distributed, as a dividend in kind, to American-Hawaiian, its parent, 10,000 shares of stock of Pacific-Atlantic Steamship Company. On November 11, 1940, American-Hawaiian agreed to sell such shares for a net amount of $582,285. There were no negotiations for the sale of the stock prior to November 11, 1940, as the Tax Court found (R. 13). American-Hawaiian executed a contract for the sale of the stock on November 22, 1940 (R. 10).

American-Hawaiian, in its income tax return for 1940, reported the receipt of said shares as a dividend of the value of $582,285 (§115(j) IRC). The tax to American-Hawaiian on this amount, as an inter-company dividend subject to the dividends-received credit (§26(b) IRC), was $20,962.26. In accordance with established rules, American-Hawaiian treated the value of the dividend as its basis for the Pacific-Atlantic stock, and consequently reported no gain on the sale of that stock. (R. 9-11).

In reviewing petitioner's return for 1940, the Commissioner included in petitioner's income $562,285, which was the difference between the net proceeds of the sale by American-Hawaiian of the Pacific-Atlantic stock and the cost of that stock to petitioner, $20,000 (R. 11).

The Tax Court held that the foregoing transactions did not result in taxable gain to the petitioner. Specifically, the Tax Court found (R. 13) that negotiations for the sale of the Pacific-Atlantic stock by American-Hawaiian had not

> "even been started by the [petitioner] corporation prior to the distribution or dividend so as to bring the instant case within the rationale of * * * *Commissioner* v. *Court Holding Co.* [324 U. S. 331] * * *"

that the declaration of the dividend on October 21, 1940 was "genuine" and the transfer of the stock on October 25, 1940 was "unconditional and final" (R. 12), and that the "first intimation" that the purchaser would be willing to buy the stock was received on November 11, 1940, by American-Hawaiian (R. 13).

The Court of Appeals (hereinafter sometimes referred to as the "court below"), reversing the Tax Court, held that the distribution of the Pacific-Atlantic shares by petitioner to its parent should be disregarded and petitioner treated as retaining ownership of such shares until November 25, 1940, when they were sold by its parent.

The theory upon which the court below disregarded the distribution by petitioner to its parent was that such distribution was not "the kind of 'distribution'" contemplated by §115(a) of the Code,* defining dividends, because, according to the court below,

> "It was not a distribution for the purposes of the Parent's business, but only in order to escape a tax * * *."

The court below said that this theory represented an application of the doctrine of *Gregory* v. *Helvering*, 293 U. S. 465 (1935), which the court held to be controlling.

In arriving at its decision, the court below virtually tried the case *de novo* on the record before it. Its action in this respect raises important questions, requiring consideration by this Court, as to the scope of the powers of courts of appeals in reviewing decisions of the Tax Court.

(1) The court below found as a fact, without any support in the record and directly contrary to findings of the Tax Court fully supported by the record, that the ultimate purchaser of the Pacific-Atlantic shares had agreed with

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* Cited erroneously throughout the court's opinion as Section 115(2). The Code contains no Section 115(2).

petitioner that he would buy the shares at petitioner's election. The court below characterized this alleged arrangement as an "option" granted by the ultimate purchaser to petitioner (R. 41).*

(2) The court below found as a fact, although the Tax Court had made no finding one way or the other, that the distribution of the Pacific-Atlantic shares was made in order to save the tax which petitioner would have incurred if it had exercised the alleged so-called "option" to sell the shares (R. 41).

(3) Although the Commissioner, both in the Tax Court (R. 11) and before the court below (Brief, p. 15), had expressly disclaimed any contention that petitioner's separate entity should be disregarded, the court below found as a fact that petitioner was the "puppet" of its parent (R. 41), that it "had no independent will of its own" (R. 40), that the parent had "declared the dividend [of the Pacific-Atlantic shares] to itself" (R. 40), and that whether petitioner or its parent sold the shares was immaterial because "the proceeds of the sale were in any event to reach the same treasury" (R. 41).

The action of the court below in trying the case *de novo* constituted a clear departure from principles of appellate procedure established by this Court with respect to the review of Tax Court decisions.

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* The present case is clearly distinguishable from *Cumberland Public Service Co.* v. *United States*, 83 F. Supp. 843 (Ct. Cls. 1949), *cert. granted* October 17, 1949. In the *Cumberland* case a formal contract was entered into between the purchaser and the stockholders of the corporation for the sale of certain property, then owned by the corporation, which was later distributed to the stockholders and transferred by them. Here, however, petitioner did not agree to sell, nor did it offer to sell, the Pacific-Atlantic shares at any time, and its parent made no agreement or offer to sell at any time while petitioner owned the stock.

It is submitted that the court below also committed gross errors of substantive law which require correction by this Court:

(1) The validity and finality of a distribution by a corporation to its stockholders in no way depends upon whether the distribution is a dividend within §115(a) I. R. C. Until the court below rendered its opinion, no one had even suggested that §115(a) had anything to do with the case. Plainly, the section has no relation to the tax liabilities of a corporation *making* a distribution.

(2) Since the petitioner's liability in no way depended upon the application of §115(a) to the distribution, the sole ground upon which the court below sought to invoke the doctrine of the *Gregory* case disappears. The *Gregory* case held that a transaction which had been undertaken not for the purpose of reorganizing a business but of effecting the distribution of a parcel of shares was not an *exempt* transaction under the reorganization sections because not within the intendment of those sections.

The effort of the court below to assimilate the present case to the *Gregory* case by treating the petitioner *as if* it were relying upon §115(a)—a section having no application to the case—and then holding that this case is not within the "purpose" of that section is, we submit, a thin disguise for the *actual holding* of the court, viz., *that any transaction, no matter how genuine and final for all other purposes, is to be disregarded for tax purposes if undertaken with a tax-saving motive.* This startling doctrine was expressly rejected by this Court in the *Gregory* case and finds no support in any other decision of this Court.

(3) The decision of the court below conflicts in principle with this Court's decision in *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200 (1935), holding that a dis-

tribution of appreciated property in the form of readily marketable securities, which the stockholders were expected to sell, did not result in the realization of gain by the distributing corporation.

Petition for rehearing, filed July 26, was denied by the Court of Appeals, without opinion, on October 4, 1949.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code (28 U. S. C. §1254(1)) and Section 1141(a) of the Internal Revenue Code (26 U. S. C. §1141(a)).

The Opinions of the Courts Below.

The opinion of the Tax Court (R. 3-14) is reported in 9 T. C. 247. The opinion of the Court of Appeals for the Second Circuit (R. 37-41) is reported in 176 F. 2d 570.

Statutes Involved.

INTERNAL REVENUE CODE:

Sec. 22. GROSS INCOME. * * *

(e) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in Section 115.

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Section 111.

Sec. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of

the amount realized therefrom over the adjusted basis provided in Section 113(b) for determining gain, • • •.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Sec. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter • • • means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year • • •.

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Sec. 1141. COURTS OF REVIEW.

(a) Jurisdiction.—

The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court • • • *in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury**; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari in the manner provided in Section 1254 of Title 28 of the United States Code. • • •

(c) Powers.—

(1) TO AFFIRM, MODIFY, OR REVERSE.—Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

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* Italics denote amendment made by Public Law 773, §36 (80th Cong. 2nd Sess.).

Facts.

Transport, Trading & Terminal Corporation, the petitioner, is a New York corporation organized in 1935 for the purpose of engaging in shipping, terminal, dock and warehouse operations. It is, and always has been, a wholly-owned subsidiary of American-Hawaiian Steamship Company, a New Jersey corporation. In December, 1937, petitioner purchased 10,000 shares of stock of Pacific-Atlantic Steamship Company at a cost of $20,000. These shares represented an interest of approximately 20% in the common stock of Pacific-Atlantic. (R. 4-5.)

In June, 1940, the British Ministry of Shipping offered to purchase four ships from Pacific-Atlantic at $50.00 per deadweight ton. On June 10, 1940, C. E. Dant, who controlled about 40% of the stock of Pacific-Atlantic, called a meeting of some of the Pacific-Atlantic stockholders to discuss the offer of the British Ministry. Representatives of petitioner attended that meeting. Some of the stockholders of Pacific-Atlantic felt that the offer should be accepted. Dant was averse to accepting the offer. He stated to those present that if they did not insist on the sale of the ships he

> "would guarantee against any loss if the ships were not sold either by buying them [the ships] or working out some other arrangement." (R. 6-7, 17.)

In reliance upon Dant's statement, the other stockholders of Pacific-Atlantic agreed that the British offer should be declined (R. 17).

On October 21, 1940, petitioner's directors adopted a resolution declaring a dividend of the 10,000 shares of Pacific-Atlantic stock. On October 25, petitioner's certificate for such shares was endorsed and delivered to American-Hawaiian. Petitioner's policy had been to pay

out in dividends "a very large proportion of its earnings of each year." (R. 9-10.)

A meeting was held in New York on October 31, 1940, attended by Dant's attorney, representatives of American-Hawaiian and other stockholders of Pacific-Atlantic. After discussion of Dant's assurance to the Pacific-Atlantic stockholders on June 10, 1940, Dant's attorney inquired whether the group present would agree to the sale of Pacific-Atlantic's *ships* to Dant or to one of his companies at $35 per ton. (The price which the British Ministry had offered in June was $50 per ton.) The other stockholders rejected this suggestion. (R. 10, 13.)

A later meeting was arranged at San Francisco on November 11, 1940. At that meeting Dant renewed the previous proposal of a sale of Pacific-Atlantic's *ships* to him at $35 per ton. "The rest of the stockholders would not agree" and "the meeting broke up without agreement" (R. 10). Later, the meeting was resumed and ultimately Dant stated that he or one of his companies would offer $60.00 per share for the Pacific-Atlantic *stock*,

> "if the stockholders would all go in on the undertaking and adjust the price in case of additional taxes being levied against Pacific-Atlantic but with no escrow or bond." (R. 10; Tr. 145.)

The Tax Court found that Dant's offer of November 11 *"was the first intimation to American-Hawaiian that Dant would be willing to buy the Pacific-Atlantic stock instead of the ships"** (R. 13).

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* This finding was based, in part, upon the testimony of Dant, a disinterested witness, that he made no offer to buy the outstanding Pacific-Atlantic stock (Tr. 52, 57); that he was "not in a position to make such an offer for several reasons" including his lack of knowledge as to certain liabilities of Pacific-Atlantic (R. 13, Tr. 52); and that the uncertainty as to what would be done to carry out his assurance of June 10 to the other stockholders continued "until November" (R. 7, 13, Tr. 55).

A final agreement for the sale was drafted and executed by American-Hawaiian and States Steamship Company, a Dant company, on November 22, 1940. Pursuant to such agreement, the sales price of $60 per share was later adjusted to $58.22 per share—approximately $5 per share less than the book value of $63.11 per share determined by Dant's accountants. (R. 8-10.)

Decisions Below.

The Tax Court held that petitioner was not to be taxed as having realized a gain because it merely parted with property, receiving nothing in return, and neither struck a bargain, nor negotiated with the ultimate purchaser, for a sale of the property distributed. The Tax Court held (R. 12-13) that the sale of the Pacific-Atlantic shares by American-Hawaiian in November, 1940 was not, in substance, a sale by petitioner, under the rule of *Commissioner* v. *Court Holding Co., supra,* 324 U. S. 331 (1945), because negotiations for the sale of the shares had not "even been started" prior to the distribution.

The Tax Court further held that *Gregory* v. *Helvering, supra,* 293 U. S. 465 (1935), did not warrant disregard of the distribution to the parent and the taxation of gain to the petitioner, stating (R. 12, 14):

> "Generally, individuals organize business corporations with the expectation that dividend payments will eventually result from their operations. It is the province of the corporate directors to determine the time and the character of the dividend payment. It is unimportant here whether the stockholder is an individual or a corporate entity. If the declaration of a dividend is genuine and the transfer is unconditional and final it is effective as such. *Only where the transaction is unreal or a sham may it be disre-*

> *garded for tax purposes. The respondent makes no such claim here."*
>
> • • • • • •
>
> "In the circumstances, the conceded fact that when the dividend in kind was declared petitioner had knowledge that if Pacific-Atlantic were liquidated or its shares purchased it would have a large taxable gain is of no legal significance. *Gregory* v. *Helvering* [293 U. S. 465] • • •." (Italics added.)

The Tax Court also rejected, as contrary to this Court's decision in *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200 (1935), the Commissioner's contention that, apart from the subsequent sale, the appreciation in value of the Pacific-Atlantic shares was realized by the petitioner merely by the distribution of such shares to its parent as a dividend in kind.

Although the record fully supported the Tax Court's finding that the first intimation that Dant would be willing to buy the Pacific-Atlantic stock came on November 11, 1940, after petitioner had parted with the stock, the court below made a contrary finding of its own (R. 40)—that Dant had granted the stockholders of Pacific-Atlantic, petitioner included,

> "an option to sell the shares to him, if they elected to do so."

This finding was based on the court's *assumption* that Dant's obligation to buy the *ships*, or produce a buyer therefor, at $50 per ton was the legal and practical equivalent of an agreement on Dant's part that, at petitioner's election, he would buy the Pacific-Atlantic stock "at $50 a ton" (R. 40).

The court's assumption is without warrant. First, it overlooks the fact that the value of the Pacific-Atlantic

shares depended not only upon the value of the ships but, among other things, upon the amount of Pacific-Atlantic's liabilities, disclosed and undisclosed, including undetermined tax liabilties. Dant testified that because he had no knowledge as to these undisclosed liabilities he was in no position to make an offer for the stock (Tr. 52, 53). Secondly, if Dant had merely purchased the ships, which was all that he was obliged to do, petitioner and the other stockholders of Pacific-Atlantic would have been left with their investment in the company, on which they could realize only by finding a purchaser or through liquidation of the company. Petitioner, as the holder of only 20% of the stock, would have been in no position to compel the liquidation of the company. Had Dant, after purchasing the ships, then decided to put the company into other shipping ventures, rather than liquidate it, petitioner could not have prevented such action.

The court below having found, however, that Dant, by agreeing to buy certain *ships* of Pacific-Atlantic, had agreed to buy the *stock* of Pacific-Atlantic at petitioner's "option" (R. 40), proceeded to hold that the declaration and payment of the dividend of Pacific-Atlantic stock should be disregarded, and the subsequent sale imputed to petitioner, on the theory that the distribution was made for tax-saving reasons and was therefore (R. 40):

> "not the kind of 'distribution' which the statute [§115(a)] had in mind; it was not a 'dividend' declared in the ordinary course of business."

The court went on to say (R. 41):

> "* * * we hold that the 'long-term capital gain'—§117(a) (4)—*was realized by the taxpayer on November 25, because* under the decisions we have already cited, *the declaration of the dividend* on

October 21 *was not that kind of 'distribution' which §115(a) presupposes* * * *." (Italics added.)

This novel theory was developed by the court below in an effort to assimilate the case to *Gregory* v. *Helvering, supra* (293 U. S. 465).

Questions Presented.

1. Did the Court of Appeals err as a matter of law (a) in substituting its own findings of fact for contrary findings of fact of the Tax Court, and (b) in reversing the Tax Court, without a remand for further hearing, upon an issue not presented to the Tax Court, viz.: whether the distribution of the Pacific-Atlantic stock should be disregarded on the theory that it was not a "dividend" within the provisions of §115(a) IRC?

2. Did the Court of Appeals err in holding that the question whether the distribution made by petitioner was a "dividend" within the meaning of §115(a) was determinative of the question whether petitioner subsequently realized taxable gain upon the sale by American-Hawaiian of the property distributed?

3. Did the Court of Appeals err in holding that the doctrine approved by this Court in *Gregory* v. *Helvering*, 293 U. S. 465 (1935), warrants the disregard of a genuine, valid and complete distribution of property to a corporation's stockholder if motivated by tax considerations?

4. Does the decision of the Court of Appeals as to the tax consequences of a distribution in kind under the facts of this case conflict in principle with this Court's decision in *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200 (1935)?

Reasons Relied on for Allowance of the Writ.

1. The writ of certiorari should be issued in order that this Court may determine fundamental questions respecting the review of Tax Court decisions, viz.:

(a) Whether the 1948 amendment of §1141(a) IRC, abrogating the rule of the *Dobson* case, empowered the Court of Appeals to try the case *de novo* on the record, reject the Tax Court's findings of fact and substitute contrary findings of its own; and

(b) Whether the Court of Appeals could properly reverse the Tax Court, without a remand of the case for further hearing, upon an issue not presented to the Tax Court, viz.: whether the distribution of the Pacific-Atlantic stock should be disregarded on the theory that it did not constitute a "dividend" within the meaning of §115(a) IRC.

(a) The decision of the Court below was based upon its finding that petitioner had obtained an agreement from Dant which obligated him to buy the Pacific-Atlantic shares at petitioner's election. In making such finding—which is squarely contrary to the Tax Court's findings (R. 13)—the Court of Appeals departed from principles of appellate procedure established by decisions of this Court and which were stated in *Wilmington Trust Co.* v. *Helvering,* 316 U. S. 164 (1942), as follows (p. 168):

> "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, *to draw inferences from the facts, and to choose between conflicting inferences.* The court may not substitute its view of the facts for that of the Board. *Where the findings of the Board are supported by substantial evidence they are conclusive.* * * * Under the statute, the court may modify or reverse the decision of the Board only if it is 'not in accordance with law.' 44 Stat. 110, 26 U. S. C. §1141(c)(1)." (Italics added.)

In *Helvering* v. *National Grocery Co.*, 304 U. S. 282 (1938), this Court said (p. 294):

> "The Court of Appeals, instead of limiting its review to ascertaining *whether there was evidence to support the Board's findings and decision,* made on all the evidence, as upon a trial *de novo,* in effect an independent determination of the matters which had been in issue before the Board. The court was without power to do so." (Italics added.)

These cases, and numerous others to the same effect,* were based upon the following statutory provision, now contained in §1141(c)(1) IRC, limiting the *powers* of appellate courts with respect to the review of Tax Court decisions:

> "(1) To AFFIRM, MODIFY, OR REVERSE.—Upon such review such courts shall have power to affirm or, *if the decision of the Board is not in accordance with law,* to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require." (Italics added.)

In 1948, Congress (by Public Law 773, §36, 80th Cong., 2d Sess.) amended §1141(a), *supra,* providing that courts of appeals have exclusive *jurisdiction* to review Tax Court decisions, by adding the phrase:

> "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury".

No change was made in the provisions of §1141(c)(1), quoted above.

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* The cases are listed in footnote 22 in this Court's opinion in *Dobson* v. *Commissioner,* 320 U. S. 489 (1943).

The court below apparently considered that, as a result of the amendment to §1141(a), it was authorized under Rule 52(a) of the Rules of Civil Procedure* to substitute findings of fact of its own for findings of the Tax Court which it conceived to be "clearly erroneous."

The conflict between the action taken by the court below and the decisions of this Court under §1141(c)(1) was called to the attention of the court below in a petition for rehearing, which was denied without opinion. In effect, therefore, the court below has held that, upon review of Tax Court decisions, courts of appeals are no longer confined to ascertaining whether "there was evidence to support the Board's findings and decision" but are free to try the case *de novo*.

It is respectfully submitted that this question should be passed upon by this Court.

The purpose of the 1948 amendment of §1141(a) was to abrogate the rule of *Dobson* v. *Commissioner*, 320 U. S. 489 (1943) (see Senate Report No. 1559, 80th Cong., 2d Sess., pp. 2, 13). In the *Dobson* case this Court held (p. 502) that appellate courts were empowered to reverse the Tax Court only in a case where the court could "separate the elements of a decision so as to identify a clear-cut mistake of law." Since the *Dobson* case narrowed very considerably the latitude which had previously been allowed to reviewing courts, it follows that Congress, in abrogating the rule of the *Dobson* case, did not necessarily intend to nullify the effect of §1141(c)(1) as interpreted in the *National Grocery, Wilmington Trust* and like decisions rendered prior to the decision in the *Dobson* case.

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* Rule 52(a) provides in part:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

The intent of Congress not to abrogate §1141(c)(1) appears affirmatively from the legislative history of Public Law 773 (which amended §1141(a)). This history shows that the original bill (H. R. 3214, 80th Cong.) proposed the repeal of §1141 in its entirety, whereas the bill, as finally enacted, made no change in §1141(c)(1), defining the *powers* of reviewing courts, but merely broadened the *jurisdiction* of courts of review by making the above-quoted amendment to §1141(a). See H. R. 3214, §§271, 1294, and Schedule of Laws Repealed, p. 786, as it passed the House.

Even if §1141(c)(1) no longer prevents a substitution by a court of appeals of its own findings of fact for those of the Tax Court, Rule 52(a) would not authorize such procedure in the present case. This is made clear by the recent decision of this Court in *United States* v. *Yellow Cab Company*, October Term, 1949, No. 22 (Dec. 5, 1949). There the Government asked this Court to retry issues of fact in an antitrust suit which were in many respects similar to the issues of fact which the Court of Appeals proceeded to retry in this case. In refusing to do so, this Court said:

> "It ought to be unnecessary to say that Rule 52 applies to appeals by the Government as well as to those by other litigants. There is no exception which permits it, even in an antitrust case, to come to this Court *for what virtually amounts to a trial de novo on the record of such findings as intent, motive and design.* While, of course, it would be our duty to correct clear error, even in findings of fact, the Government has failed to establish any greater grievance here than it might have *in any case where the evidence would support a conclusion either way* but where the trial court has decided it to weigh more heavily for the defendants. *Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous'.*" (Italics added.)

A fortiori, in the present case, the findings of the Tax Court cannot properly be held to be "clearly erroneous" where there was no evidence contrary to the finding that Dant made no agreement with the petitioner to purchase the Pacific-Atlantic stock, and where the Government itself did not attack the correctness of such finding before the court below, either by way of assignment of error or otherwise.

Petitioner submits that under these circumstances the court below was without power, either under §1141(c)(1) IRC or Rule 52(a) of the Rules of Civil Procedure, to make its own independent findings of fact as to the scope of Dant's undertaking and thereby substitute its view of the facts for that of the Tax Court.

(b) The court below could not properly reverse, without a remand, upon an issue not presented to the Tax Court.

The court below held (R. 41) that the gain

> "• • • was realized by the taxpayer on November 25, because under the decisions we have already cited, the declaration of the dividend on October 21 was not that kind of 'distribution' which §115(a) presupposes."

In order to arrive at this conclusion the court below found it necessary to disregard the separate entities of petitioner and its parent. It did so by finding that "the Parent's will was the taxpayer's, which had no independent will of its own", that "Parent, acting through the taxpayer, • • • declared the dividend to itself", that the petitioner was "the Parent's puppet", and that since the proceeds of any sale of the Pacific-Atlantic stock "were in any event to reach the same treasury" it was "altogether irrelevant that the title to the shares passed from the Parent or not from the taxpayer" (R. 40-41).

Petitioner was not required to meet any such issue before the Tax Court because the Commissioner disclaimed any contention that the separate entities of petitioner and its parent should be disregarded. The Tax Court opinion expressly states that the Commissioner made no such contention (R. 11). Before the Court of Appeals, the Commissioner again disclaimed any such contention (Brief, p. 15).

Therefore, even if the court below was correct in holding that the petitioner's liability depended upon whether the distribution of the Pacific-Atlantic stock was a "dividend" within the meaning of §115(a), the court below was not authorized to reverse on this ground and sustain the deficiency. *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 200 (1935). The court, having determined to reverse on such issue, should have remanded the case for a further hearing thereon, pursuant to the provisions of §1141(c)(1) IRC authorizing courts of appeal, when reversing for errors of law, to remand the case "for rehearing, as justice may require". *Hormel* v. *Helvering,* 312 U. S. 552 (1941).

In the *Hormel* case the question was raised for the first time before the circuit court whether the taxpayer, as grantor of a trust, was taxable on the income thereof under the provisions of §22(a). The circuit court reversed the Tax Court and held the grantor taxable on that theory. This Court agreed with the circuit court, but held that the case should have been remanded, saying (p. 560):

> "But the Board of Tax Appeals neither found the facts nor considered the applicability of 22(a) in the light of the *Clifford* case. Congress has entrusted the Board with exclusive authority to determine disputed facts. Under these circumstances we do not feel that petitioner should be foreclosed

from all opportunity to offer evidence before the Board on this issue, however remote may be his chance to take his case out of the *Clifford* rule. Accordingly, the judgment of the lower court reversing the decision of the Board of Tax Appeals is affirmed, with directions to the Board of Tax Appeals for further proceedings in accordance with this opinion."

2. The writ of certiorari should be issued to determine whether, as the Court of Appeals held, the rule of the *Gregory* case warrants the disregard of a valid and genuine corporate distribution on the theory that it was made for tax-saving purposes and was therefore not a "dividend" within the meaning of §115(a) IRC.

It is submitted that this holding of the Court of Appeals, if correct, involves a new and important principle of federal income tax law which has not been, but should be, passed upon by this Court.

The *Gregory* case, *supra* (293 U. S. 465) did not hold that the tax consequences of transactions depend on whether they have a "business purpose" or a tax-saving purpose.

The facts of the *Gregory* case were that the taxpayer owned all the shares of United Mortgage Corporation, which owned 1,000 shares of Monitor Securities Co. The taxpayer desired to sell the Monitor shares. She caused the organization of the Averill Corporation and the transfer to Averill of the Monitor shares in exchange for the issuance of the Averill shares to her. Three days later, Averill was dissolved and the taxpayer received the Monitor shares as a liquidating distribution and sold them.

The taxpayer, Gregory, claimed that the transfer from United to Averill was "a transfer by a corporation of * * * a part of its assets to another corporation" of which taxpayer, the transferor's stockholder, was in control imme-

diately thereafter, and that therefore the transactions were within one of the statutory definitions of a "reorganization" and, as such, were exempt from tax.

This Court held that the transactions did not come within the statutory exemption because they represented, not a plan "to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner" (293 U. S. at p. 469).

This Court deemed the tax-saving motive in the transaction to be wholly irrelevant, saying (pp. 469-470):

> "the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended.
>
> • • • • • •
>
> The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute."

Here, therefore, the petitioner's motive in distributing the Pacific-Atlantic stock was not only not controlling but was altogether immaterial. No question could arise under the rule of the *Gregory* case because the petitioner did not rely upon the reorganization provisions or any other *statutory provision* to relieve it of tax liability. Petitioner simply relied upon the *fact* that it had distributed the stock to its parent and that the parent had made the sale of the stock.

Since the Tax Court had found that the distribution *was a fact* and that the sale *was made* by the parent, the Court of Appeals, in order to frustrate a tax-saving which it deemed objectionable, was obliged, *first*, to treat the petitioner *as if* it had relied upon a statute to relieve it of tax liability and, *second*, to hold that the transaction was not within the purpose of the imputed statute and was therefore not exempt thereunder.

The statute which the court seized upon, in its effort to assimilate the case to the *Gregory* case, was §115(a), defining a "dividend" as "any distribution made by a corporation to its shareholders, whether in money or in other property" out of the earnings and profits of the distributing corporation.

But it is perfectly clear that the petitioner's tax liability does not depend on whether the distribution of the Pacific-Atlantic stock was a "dividend" within the meaning of §115(a). What controls is not a statute governing the tax treatment of distributions *received* by stockholders but the *fact* that the distribution of the Pacific-Atlantic stock was made by the petitioner and that petitioner received nothing in return therefor. The court's holding that the distribution here should be disregarded is nothing more or less than a holding that the tax consequences of a transaction depend not upon what was done but upon the presence or absence of a tax-saving motive.

Under the novel theory adopted by the court below, if an owner of real estate, following a common practice in late years, tore down a house to avoid liability for real estate taxes from year to year, he would still have to pay taxes on the house, the tearing down being disregarded as a scheme to avoid tax liability.

It is submitted that it is important to taxpayers generally, to the Commissioner and to the lower courts to learn from this Court whether the decision of the court below represents a correct application of the *Gregory* case.

3. The decision should be reviewed because the action of the court below in disregarding the distribution made by the petitioner conflicts in principle with this Court's decision in *General Utilities & Operating Co.* v. *Helvering*.

Before the Tax Court, the Commissioner contended that the distribution of Pacific-Atlantic stock of itself con-

stituted a realization by petitioner of the excess of the appreciation in value of such stock over the cost thereof to petitioner, the distributing company. The Tax Court rejected this contention as contrary to the decision of this Court in *General Utilities & Operating Co.* v. *Helvering, supra* (296 U. S. 200) wherein this Court held that the distribution of appreciated property did not result in the realization of gain by the distributing corporation.

In recent years the question whether the distribution of appreciated property gives rise to gain by the distributing company has been almost constantly before the Tax Court. Thus, since 1944, the Tax Court has been called upon to review at least eleven cases*, in addition to the present case, in which the Commissioner determined that corporations realized gain upon the distribution of appreciated property. During the same period the Tax Court has reviewed twelve other cases** in which the Commissioner

---

* *Beach Petroleum Corp., Ltd.*, memo. op. 5 T. C. M. 638 (1946); *Scientific Production Corp.* memo. op. 4 T. C. M. 328 (1945); *J. A. Folger & Co.*, memo. op. 4 T. C. M. 710 (1945); *Southwest Consolidated Corp.*, memo. op. 5 T. C. M. 6 (1946); *Marlen Realty Co.*, memo. op. 3 T. C. M. 1178 (1944), Comm'r's appeal dismissed, 151 F. 2d 1016 (8th Cir. 1945); *Earle Real Estate Co.*, memo. op. 6 T. C. M. 667 (1947); *J. L. Washburn Estate, Inc.*, memo. op. 3 T. C. M. 1192 (1944); *Nemours Corp.*, memo. op. 6 T. C. M. 820 (1947); *Columbia Development Corp.*, memo. op. 6 T. C. M. 548 (1947); *Horne Oil Co.*, memo. op. 6 T. C. M. 233 (1947); *Smith Bros. Refinery Co., Inc*, memo. op. 5 T. C. M. 17 (1946).

** *Jane E. Bradley*, 9 T. C. 115 (1947); *Paulina D. Dean*, 9 T. C. 256 (1947); *Herbert G. Hanan*, memo. op. 3 T. C. M. 670 (1944); *John H. Acheson, Est.* memo. op. 3 T. C. M. 1242 (1944); *Elizabeth N. Sager*, memo. op. 3 T. C. M. 1176 (1944); *Edith K. Timken*, memo. op. 3 T. C. M. 631 (1944); *Carl A. Fisher*, memo. op. 3 T. C. M. 393 (1944); Comm'r's appeal dismissed 150 F. 2d 1019 (10th Cir. 1945); *National Carbon Co.*, 2 T. C. 57 (1943); *Walter B. Congdon*, memo. op. 3 T. C. M. 516 (1944); *Charles R. McLean*, memo. op. 3 T. C. M. 1174 (1944); *Howard C. Platt Trust*, memo. op. 4 T. C. M. 715 (1945), Comm'r's appeal dismissed, 154 F. 2d 1016 (9th Cir. 1946); *G. W. Grandin*, memo. op. 4 T. C. M. 1031 (1945). See also *Comm'r* v. *Timken Estate*, 141 F. 2d 625 (6th Cir. 1944), aff'g 47 B. T. A. 494 (1942).

determined that such a distribution gave rise to "earnings and profits" so as to fix the character of the distribution as a taxable dividend. In each of such cases, the Tax Court overruled the Commissioner's determination.

If the decision of the Court below is permitted to stand, however, the Commissioner will have accomplished his purpose of upsetting the holding of the *General Utilities* case, at least in the great majority of cases where the distribution in kind is made in the expectation that the stockholders will sell the distributed property (which they are frequently obliged to do in order to find the funds with which to pay the tax on the dividend). In form, the tax will not be imposed on the theory that distribution of the appreciated property was a realization of gain. The same result will be accomplished, however, by the formula of (a) disregarding the distribution and (b) taxing the distributing corporation on the excess of the proceeds from the stockholder's sale over the basis which the property had in the hands of the corporation.

This result cannot be reconciled in principle with the holding of this Court in the *General Utilities* case, where readily marketable securities were distributed in the expectation that they would be sold. Neither can it be reconciled with the statutory provisions limiting taxable gain on the "sale or other disposition of property" to the excess of the money or property *received* over the basis of the property (§22(f) and §111 IRC).

It is submitted that the decision below calls for a restatement by this Court of the principle, established by the *General Utilities* case, that a corporation distributing appreciated property, which it has not agreed to sell, realizes no gain as a result of the distribution for the reason that it has merely parted with property, receiving nothing in return.

Conclusion.

The petition for a writ of certiorari should be granted in order

(1) to determine whether appellate courts have power to substitute their own findings of fact for findings made by the Tax Court which are based upon substantial evidence;

(2) to correct the gross procedural error committed by the court below in reversing the decision of the Tax Court, without a remand for further hearing, upon an issue which was not tried in the Tax Court, viz., whether the distribution by petitioner to its parent should be disregarded on the theory that it was not a "dividend" within the meaning of §115(a);

(3) to determine whether the court below correctly applied, or completely distorted, the principle of this Court's decision in the *Gregory* case by holding that any transaction entered into with a tax-saving motive may be disregarded in order to impose a tax; and

(4) to resolve the essential conflict between the decision of the court below, that a distribution in kind may be disregarded if made with expectation of sale, and the holding of this Court in the *General Utilities* case.

Respectfully submitted,

Arthur A. Ballantine,
Charles C. Mac Lean, Jr.
Counsel for Petitioner.

December, 1949.

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Supreme Court of the United States

OCTOBER TERM, 1949.

No. 505.

TRANSPORT, TRADING AND TERMINAL CORPORATION,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY BRIEF.

ARTHUR A. BALLANTINE,
CHARLES C. MACLEAN, JR.,
Counsel for Petitioner.

January, 1950.

INDEX.

PAGE

1. The holding of the court below is directly in conflict with the principles affirmed in the *Cumberland* case 3

   (a) that determination of whether a sale has been made by a corporation or its stockholders is a question of fact for the trial court; and 3

   (b) that a distribution in kind by a corporation to its stockholders, found by the trial court to be genuine, cannot be disregarded because undertaken to save a tax on the distributing corporation 3

2. Everything which this Court has said in the *Cumberland* case in defining the tax consequences of a distribution in kind made in liquidation is equally applicable to dividends in kind 7

CONCLUSION 9

Citations.

Cases:

	PAGE
Commissioner v. *Court Holding Co.*, 324 U. S. 331 (1945)	3
General Utilities & Operating Co. v. *Helvering*, 296 U. S. 200 (1935)	9
Gregory v. *Helvering*, 293 U. S. 465 (1935)	4, 9
E. C. Laster, 43 B. T. A. 159, 176 (1940)	5
Tennessee-Arkansas Gravel Co. v. *Comm'r*, 112 F. 2d 508 (6th Cir. 1940)	5
United States v. *Cumberland Public Service Company* (No. 214, October Term, 1949)	1, 2, 3, 4, 6, 7, 8, 9

Statutes:

Internal Revenue Code:	
§22(f)	8
§45	5
§111(a)	8
§111(b)	8
§115(a)	5

Other Authorities:

Reg. 103.	
§19.45-1(c)	5

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PETITIONER'S REPLY BRIEF.

It is now clear that the petition for a writ of certiorari should be granted as the decision below is in square conflict with the decision of this Court in *United States* v. *Cumberland Public Service Company* (No. 214, October Term, 1949), rendered January 9, 1950, after the petition herein was filed.

The whole argument turns on the holding of the court below that a dividend in kind of certain stock from the petitioner to its parent company, which the Tax Court found was not "unreal or a sham" but was "genuine • • • unconditional and final", should be disregarded, and a subsequent sale of the stock imputed to petitioner, on the ground that the dividend distribution was made in order to escape a tax.

This Court held in the *Cumberland* case that a distribution in kind by a corporation to its stockholders, which the trial court found to be genuine, could *not* be disregarded, and a sale of the distributed property, made by the stockholders, imputed to the corporation, on the ground that the distribution in kind was made in order to escape a tax.

The conflict between the decision of the court below and the decision of this Court in the *Cumberland* case is clear and in itself warrants the grant of a writ in this case. That case, like this, arose because a stockholder of a corporation sold property received from the corporation, and in each case the Commissioner asserted a corporate tax liability on the theory that the distribution to the stockholder should be disregarded because made in order to save a tax. This theory was rejected by this Court in the *Cumberland* case but accepted by the court below in this case.

Contrary to the Commissioner's suggestion, no valid distinction can be drawn between this case and the *Cumberland* case on the ground that this case involves a dividend in kind whereas the *Cumberland* case involved a distribution in kind made in liquidation. In each case, the question is simply: Who made the sale—the distributing corporation or its stockholders? On this question, as this Court said in the *Cumberland* case,

> "It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which the particular transaction belongs."

In view of the substantial identity of the issues in this case and the *Cumberland* case, denial of the writ in this case would amount to a negation of everything that this Court so recently said in the *Cumberland* case.

1. The holding of the court below is directly in conflict with the principles affirmed by this Court in the *Cumberland* case:

(a) that determination of whether a sale has been made by a corporation or its stockholders is a question of fact for the trial court; and

(b) that a distribution in kind by a corporation to its stockholders, found by the trial court to be genuine, cannot be disregarded because undertaken to save a tax on the distributing corporation.

In the present case the Tax Court held that the sale here involved was not "in substance" a sale by petitioner within the rationale of *Commissioner* v. *Court Holding Co.*, 324 U. S. 331 (1945), because there were no negotiations for the sale of the stock in question prior to a genuine distribution thereof as a dividend in kind.*

These findings of the Tax Court, based upon adequate supporting findings, were conclusive upon the reviewing court, under the decisions of this Court in both the *Court Holding* and *Cumberland* cases.

The Commissioner attempts to support the decision below by arguing that the Tax Court erred, as a matter of law, in holding that the dividend distribution was genuine and that the sale was not made by petitioner because, so the Commissioner says, the distribution was a "device" to avoid taxation (Br. in Opp., p. 13). This same argument was advanced by the Commissioner in the *Cumberland* case. (See page 13 of Commissioner's brief in the *Cumberland*

* In contrast, in the *Cumberland* case there had not only been negotiations for the sale of the property prior to the distribution thereof to the stockholders but the stockholders had entered into a formal contract to convey the property which they proposed to acquire from the corporation through its dissolution.

case, citing *Gregory* v. *Helvering*, 293 U. S. 465, and other cases cited at page 13 of his brief in opposition here.) This Court answered such argument as follows:

> "Here, on the basis of adequate subsidiary findings, the Court of Claims has found that the sale in question was made by the stockholders rather than the corporation. The Government's argument that the shareholders acted as a mere 'conduit' for a sale by respondent corporation must fall before this finding. The subsidiary finding that a major motive of the shareholders was to reduce taxes does not bar this conclusion. Whatever the motive and however relevant it may be in determining whether the transaction was real or a sham, sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes."

The same answer applies to the Commissioner's argument here and requires the reversal of the decision below. To say, as the court below did, that the dividend in kind should be disregarded because it was "only a step in the means by which it [the parent] intended to carry out the sale" is simply a different phrasing of the "conduit" argument rejected by this Court in the *Cumberland* case. To say, as the court below did, that the dividend in kind should be disregarded on the theory that it was not a "dividend" within the meaning of §115(a) I. R. C., because undertaken for tax-saving purposes, was simply a roundabout way of stating the same rejected argument.

The answer to all such arguments, no matter in what form stated, is, as this Court held in the *Cumberland* case, that they must fall before findings of the trial court that the sale in question was made by stockholders, rather than the corporation, following a genuine distribution.

Significantly, the Commissioner makes no attempt to defend the decision below on the ground that the distribution did not constitute a "dividend" within the meaning of §115(a) because undertaken for tax-saving purposes—the theory upon which the court below rested its decision. Instead, the Commissioner cites another section of the Code, never before relied upon in this case either in the Tax Court or in the court below, viz., §45 I. R. C., which authorizes the Commissioner, in certain cases, to "distribute, apportion, or allocate" income among controlled organizations in order to prevent evasion of taxes or clearly to reflect the income of such organizations.

Section 45 could have no application to the present case. If petitioner had realized gain through negotiating a sale of the property in question, there would be no occasion to invoke §45 for the purpose of allocating such gain to the petitioner. If, on the other hand, as the Tax Court has held, the sale was made by petitioner's parent company, after receipt of a genuine dividend in kind, there was no income to the parent which could be allocated to petitioner under §45, because the proceeds of sale did not exceed the parent's basis for such property.* And the dividend income which the parent company derived from the receipt of the property as a dividend in kind was certainly not allocable to the petitioner which had paid such dividend.

Section 45 was intended to be applied to sham or fictitious transactions (Reg. 103, §19.45-1(c)). It cannot be applied to a dividend in kind which the Tax Court has found to be genuine, unconditional and final, and not sham

* The courts have held that §45 may not be used to create income where none exists. *Tennessee-Arkansas Gravel Co.* v. *Comm'r*, 112 F. 2d 508 (6th Cir. 1940); *E. C. Laster*, 43 B. T. A. 159, 176 (1940).

or unreal. As the Tax Court said, corporations are organized "with the expectation that dividend payments will eventually result from their operations" (R. 12). This is the answer to the Commissioner's assertion that no bona fide reason can be suggested for the declaration of the dividend.

Neither in the court below nor in this Court has the Commissioner challenged the adequacy of the evidence supporting the Tax Court's findings. He seeks here to emphasize two extraneous facts found by the Tax Court and weighed by it in arriving at its determination that the dividend was genuine and that the petitioner did not negotiate the sale. These extraneous facts are, first, that three years prior to the dividend in kind the petitioner acquired the stock in question from its parent in a transaction which gave rise to a deductible loss to the parent. As the record shows, this loss was sustained upon a sale made at public auction and was allowed by the Commissioner after careful audit (Cert. Tr. 174-5). The second fact stressed by the Commissioner is that petitioner's parent made a substantial investment in petitioner in the same year in which the dividend in kind was declared. As the Tax Court's opinion shows, this investment was made to enable the petitioner to carry out current business transactions of importance (R. 7-8).

It is submitted that the Tax Court was correct in considering that neither of the circumstances mentioned could have any bearing in determining whether petitioner had negotiated a sale of the stock in question to Dant prior to the payment of the dividend in kind. Certainly neither of such circumstances affords any valid ground of distinction between this case and the *Cumberland* case which could warrant denial of the writ here.

2. Everything which this Court has said in the *Cumberland* case in defining the tax consequences of a distribution in kind made in liquidation is equally applicable to dividends in kind.

In the *Cumberland* case this Court stated the basis of its decision as follows (slip opinion, pp. 4-5):

> "While the distinction between sales by a corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial when the corporation is closely held, Congress has chosen to recognize such a distinction for tax purposes. The corporate tax is thus aimed primarily at the profits of a going concern. This is true despite the fact that gains realized from corporate sales are taxed, perhaps to prevent tax evasions, even where the cash proceeds are at once distributed in liquidation. *But Congress has imposed no tax on liquidating distributions in kind* or on dissolution, whatever may be the motive for such liquidation.
>
> * * *
>
> " * * * a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet is not taxed if that property is distributed in kind and is then sold by the shareholders.* * *
>
> *"Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate."* [Italics added.]

The foregoing reasoning is equally applicable here. Congress has imposed no tax upon a corporation paying

a dividend in kind, whatever may be the motive for such dividend. Congress has provided in §§22(f) and 111(a) and (b) I. R. C. that gain from the disposition of property shall be measured by what is *received* from such disposition. A corporation distributing property pursuant to a dividend in kind receives nothing on account of such distribution; therefore, under the statute, such corporation owes no tax with respect thereto.

Congress having provided that no tax shall be payable in respect of the distribution of dividends in kind, the court below should not have undertaken to defeat the Congressional mandate by holding that a genuine dividend in kind should, as a matter of law, be disregarded, and a subsequent sale of the distributed property imputed to the distributing corporation, on the ground that the distribution was made to escape a tax.

The Commissioner suggests that the rule of the *Cumberland* case should be restricted to liquidations, and points out that in the passage of the opinion quoted above the Court said: "The corporate tax is thus aimed primarily at the profits of a going concern." In this connection the Commissioner states (p. 12) that the transfer of the stock here in question was made "while petitioner was actively engaged in business" so that a sale by petitioner would have resulted "in its having realized normal business profits." The fact is, of course, that the taxpayer was engaged in shipping, terminal, dock and warehouse operations, that the stock here in question was a capital asset and not an asset held for sale in the ordinary course of petitioner's business, and that any gain that petitioner might have realized had it sold the stock would have been capital gain and not, as the Commissioner says, "normal business profits."

Aside from these facts, when the above-quoted sentence from the Court's opinion is read in its context, it is clear that the Court did not mean thereby to imply that the corporate tax was "aimed" at dividends in kind paid by a continuing corporation; rather, the Court was simply directing attention to the fact that sales made by a corporation, whether as a going concern or while in process of liquidation, are subject to the corporate tax, whereas Congress has not imposed the corporate tax on distributions made in liquidation.

So also, Congress has not imposed the corporate tax on dividends in kind of appreciated property distributed by a going corporation. The holding of this Court in *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 200 (1935), is square authority for this proposition. The Commissioner says (p. 14) that "there has been considerable confusion as to the precise holding" of the *General Utilities* case on this point. There is no such confusion, however, in the mind of the Tax Court which, as shown in the petition herein (p. 23), has cited and followed the *General Utilities* case not only in this case but in every other case in which the question has been raised whether dividends in kind give rise to income. In no case has the Commissioner prosecuted an appeal from a decision of the Tax Court on this point.

Conclusion.

The decision below is wrong. It conflicts with the decision of this Court in the *Cumberland* case and misconstrues the decision of this Court in the *Gregory* case. Denial of the writ herein would be regarded by the lower courts as a clear indication that the principles laid down

by this Court in the *Cumberland* case are not general but applied only to the particular case before the Court, or, at most, apply only to distributions in kind made in liquidation. The petition for a writ of certiorari, accordingly, should be granted.

Respectfully submitted,

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Counsel for Petitioner.

January, 1950.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	4
Argument	7
Conclusion	15

CITATIONS

Cases:

Commissioner v. *Court Holding Co.*, 324 U. S. 331	13, 14
Dobson v. *Commissioner*, 320 U. S. 489	14
Fairfield S.S. Corp. v. *Commissioner*, 157 F. 2d 321, certiorari denied, 329 U. S. 774	14
General Utilities Co. v. *Helvering*, 296 U. S. 200	14, 15
Gregory v. *Helvering*, 293 U. S. 465	13
Griffiths v. *Commissioner*, 308 U. S. 355	13
Higgins v. *Smith*, 308 U. S. 473	13
Minnesota Tea Co. v. *Helvering*, 302 U. S. 609	13
National Carbide Corp. v. *Commissioner*, 336 U. S. 422	14
United States v. *Cumberland Public Service Co.*, decided January 9, 1950	12, 14

Statutes:

Internal Revenue Code:	
Sec. 22 (26 U.S.C. 1940 ed., Sec 22)	2
Sec. 45 (26 U.S.C. 1940 ed., Sec 45)	3, 13
Sec. 111 (26 U.S.C. 1940 ed., Sec. 111)	3
Sec. 112 (26 U.S.C. 1940 ed., Sec. 112)	4
Sec. 1141	14

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 505

TRANSPORT TRADING & TERMINAL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3-14) are reported at 9 T. C. 247. The opinion of the Court of Appeals (R. 37-41) is reported at 176 F. 2d 570.

JURISDICTION

The judgment of the Court of Appeals was entered on July 11, 1949. (R. 42.) A petition for rehearing was filed on July 26, 1949 (R. 43-57), and

was denied on October 4, 1949 (R. 71). The petition for a writ of certiorari was filed on December 28, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

The taxpayer, for the sole purpose of avoiding tax on an imminent profit, declared a dividend in kind to its parent company, consisting of certain shares of stock in another company. This was done with the knowledge that the stock would be immediately sold or its value otherwise realized on.

Did the Court of Appeals err in deciding that the gain, realized by a sale of the stock, was taxable to the taxpayer?

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Section 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such prop-

erty; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U. S. C. 1940 ed., Sec. 45.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis pro-

vided in such section for determining loss over the amount realized.

* * * * *

(26 U. S. C. 1940 ed., Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(26 U. S. C. 1940 ed., Sec. 112.)

STATEMENT

The findings of fact made by the Tax Court (R. 4-11) may be summarized as follows: The taxpayer corporation, which is engaged in shipping, terminal, dock, and warehouses operations, is a wholly owned subsidiary of a parent company, the American-Hawaiian Steamship Company. (R. 4.)

In 1929, the parent company purchased 10,000 shares of common stock of the Pacific-Atlantic Steamship Company, at a cost of $500,000. This constituted 20 percent of the outstanding stock of that company. In 1937, the parent company sold these shares to the taxpayer for $20,000. In its tax return for that year, the parent company claimed a loss of $480,000 on this sale, and the loss was used to offset substantial capital gains for that year. (R. 5.)

Pacific-Atlantic, which was engaged in intercoastal shipping, owned 13 ships at the beginning of 1940. Its operations had not been profitable; the taxpayer and the other large stockholders were desirous of getting out of the company. At that time there was a good market for ships and the larger stockholders decided that it was for the best interests of all the stockholders that the ships and assets of the company be sold. Authority to make such sales was secured from the stockholders and by June 1, 1940, nine of the ships had been sold. There was then pending an offer from the British Ministry of Shipping to purchase the remaining four ships at $50 per deadweight ton. (R. 5-6.)

On June 10, 1940, Charles E. Dant, one of the large stockholders, called an informal meeting of the stockholders to discuss the pending offer from the British Ministry of Shipping. Dant was averse to accepting the offer because he did not want the Pacific-Atlantic Company to go out of business. He stated to those present, including the taxpayer, that if they would not insist on the sale of the ships, he would "guarantee them 'against any loss if the ships were not sold either by buying them or working out some other arrangement.'" Dant did not say how he would carry out his assurance, but at this meeting the parties also reached a basis for the valuation of the common stock of Pacific-Atlantic—the four unsold ships were to be valued at $50 per ton deadweight, treated as though sold at that price,

and the profit taken into account subject to federal and state taxes; the profits on all voyages in progress on June 10, 1940, were also to be taken into account. As a result of this meeting, the authority to sell the remaining four ships was rescinded. (R. 6-7.)

On July 15, 1940, the taxpayer increased its capital stock by $900,000, par value, the shares being issued to the parent company in exchange for $537,000 in cash and for shares of stock in another steamship company. (R. 8.)

On October 1, 1940, Dant and the president of Pacific-Atlantic instructed a firm of public accountants to compute the book value of the Pacific-Atlantic common stock in accordance with the basis mentioned above. September 30, 1940, was chosen as the valuation date because all voyages pending on June 10 were completed by that time. This audit showed a book value of $63.11 per share. (R. 8-9.)

On October 21, 1940, the taxpayer's directors declared a dividend on its capital stock consisting of the 10,000 shares of Pacific-Atlantic stock. The stock was transferred to the parent company on October 25, 1940. (R. 9.)

On October 31, 1940, a meeting was held at which Dant inquired whether the group present would agree to the sale of the remaining ships to Dant or to one of his companies at $35 per ton. The taxpayer's parent objected to a sale at less than market value. A later meeting was held on November 11, 1940, at which various proposals were rejected. It

was finally agreed that Dant or one of his companies would purchase the stock from the Pacific-Atlantic stockholders at $60 per share, with an adjustment for possible additional tax liabilities of Pacific-Atlantic. On November 25, 1940, the taxpayer's parent delivered the 10,000 shares of Pacific-Atlantic stock to one of Dant's companies for a final adjusted price of $582,285. (R. 10.)

The Commissioner, in his deficiency determination, included in the taxpayer's taxable income for 1940 the sum of $562,285, that being the difference between the cost basis to the taxpayer and the selling price of the stock. (R. 11.) The Tax Court refused to sustain the Commissioner's deficiency determination. (R. 11-14.) The Court of Appeals reversed the Tax Court, holding that the Commissioner should have been sustained. (R. 37-41.)

ARGUMENT

1. The principal attack made by the taxpayer on the decision of the Court of Appeals rests on the assertion that it exceeded its reviewing authority with respect to certain factual issues. (Pet. 3-5, 11-12, 14-20.) An examination of the specific matters complained of, however, fails to reveal that these errors are embodied in the opinion written by Judge Learned Hand or that the decision results from any such usurpation of power by the court below.

a. The taxpayer first asserts that the Court of Appeals (Pet. 3-4)—"* * * without any support

in the record and directly contrary to findings of the Tax Court fully supported by the record * * *"—determined that the ultimate purchaser (Dant) had agreed to purchase the "Pacific-Atlantic shares" at the taxpayer's election. This assertion, which is basic to the taxpayer's complaint (Pet. 3-4, 10-12, 13, 14, 18), misconceives the decision of the Court of Appeals and the factual findings of the Tax Court. Judge Hand's opinion does not rest on the rationale that the purchaser was obligated to buy the shares of stock; it holds only that the purchaser was at least " 'committed' to buy the ships" from the Pacific-Atlantic Company. (R. 40.) The Tax Court made no findings contrary to this. Actually, the Tax Court's findings with respect to the offer require such a conclusion, as the very minimum, for Dant was found by the Tax Court to have "guarantee[d] them [the Pacific-Atlantic shareholders] 'against any loss if the ships were not sold *either by buying them* or working out some other arrangement.' " (R. 7, italics added.) Since Dant was obligated to purchase the ships, and since these were the only remaining assets of the Pacific-Atlantic Company (R. 6), it was an inevitable conclusion that, by requiring the purchaser to carry out his minimum commitment, the Pacific-Atlantic stockholders would eventually realize on the value of their shares. The court below did not conclude that the stockholders had a right to compel the purchaser to buy their shares in a direct purchase. The

opinion, after referring to Dant's undeniable offer to buy the ships, carefully states that (R. 40) "* * * *that in effect* gave them—the taxpayer included—an option to sell the shares to him, if they elected to do so." (Italics added.)[1]

The Tax Court, moreover, completely overlooking what the purchaser was bound to do, placed its emphasis on the fact that the stockholders were not bound to sell their shares. (R. 13-14.) The Court of Appeals did not deny this. It concluded, however, that the significant fact was that the taxpayer and the parent company had determined to require the purchaser to carry out his obligation, a matter not denied by the Tax Court and which, as the court below pointed out (R. 40), could not be denied on the record.

b. The second matter in which the Court of Appeals is supposed to have exceeded its reviewing authority (Pet. 4) is its conclusion (R. 41) that the taxpayer's distribution of the shares to the parent was done only to escape tax. The complaint here is not that this conclusion conflicts with a finding made by the Tax Court, but only that (Pet. 4): "* * * the Tax Court had made no finding one way or the other * * *." The Tax Court actually noted (R. 14) that it was a "conceded fact" that

[1] It is significant (a) that on June 10, 1940, when Dant made his commitment, the parties present at the meeting simultaneously agreed upon a basis for the valuation of the Pacific-Atlantic stock which valued the ships at $50 per ton (R. 7), and (b) that as soon as the stock could be valued on the agreed basis, the valuation was undertaken early in October (R. 8-9). *Supra*, pp. 5-6.

the taxpayer knew, at the time that it transferred the stock to the parent, that it would have a large taxable gain if the shares were sold directly or if the Pacific-Atlantic Company were liquidated. The record, moreover, does not disclose, and the taxpayer is unable to suggest any *bona fide* reason why this inter-company transaction did take place. The taxpayer's attempted explanation below, which has not been repeated here, was properly rejected by the court as being invalid. (R. 41.) Except for the attempt to avoid the tax, the transfer to the parent was without reason.

c. The final factual matter in which the taxpayer claims that the Court of Appeals went beyond the proper scope of review is the court's conclusions that the subsidiary had no will different or independent from that of the parent and that the ultimate financial interests of both companies were the same. (Pet. 4.) Again, it will be noted that the Tax Court made no contrary findings, and, we submit, none would be possible. The fact that the taxpayer's stock was wholly owned by the parent and that they possessed common officers and directors (R. 4) inevitably leads to the conclusion that the subsidiary's actions were controlled by the parent and that they possessed no conflicting financial interests. The court could reach no other conclusion but that (R. 41) "* * * the proceeds of the sale were in any event to reach the same treasury * * *."

The taxpayer's attempt (Pet. 3, 4) to present the case as though the Court of Appeals had tried these matters *"de novo"* is, accordingly, without foundation.

2. There is a similar lack of merit to the taxpayer's alternative contention that the Court of Appeals should have, at least, remanded the case to the Tax Court. (Pet. 18-20.) The basis for this argument is the unwarranted premise that the court below reached its decision by disregarding corporate entities (Pet. 18), and that the Commissioner had disclaimed any such contention in the Tax Court (Pet. 19). The Court of Appeals, in concluding that the subsidiary's will was dominated by the parent and that the two corporations had an identity of financial interests, did not disregard corporate entities. It was merely stating a self-evident conclusion. Indeed, there would have been no need for Judge Hand to have reasoned as he did in the opinion if the court had simply disregarded the corporate entity of the parent. Furthermore, if the court below had disregarded any corporate entity, its reasoning would have required that the subsidiary's should be ignored. This, of course, is contrary to its decision that the gain was taxable to the subsidiary.

3. On the undeniable facts of the case, the Commissioner was warranted in concluding that, as between these two members of an inter-corporate

family, the gain was realized by the subsidiary. It will be noted that this very block of stock in the Pacific-Atlantic Company had been the subject of an inter-company transfer which occurred only three years previously—a transaction whereby the parent sold the stock to the taxpayer for $20,000, and as a result of which it claimed and was allowed a capital loss deduction of $480,000 in its tax return for 1937. (R. 5.) It was this same stock which was again sold in the taxable year for $582,285. (R. 10.) It is also significant that only three months prior to the so-called "dividend distribution" of the Pacific-Atlantic Company stock to the parent, and after the time that the purchaser had made his commitment, the taxpayer increased its capital stock by $900,000, the shares being issued to the parent in exchange for $537,000 in cash and shares of stock in another steamship company. (R. 8.)

The transfer of the Pacific-Atlantic stock to the parent in this case, moreover, was made by the taxpayer while it was actively engaged in business, so that a direct sale of that stock by the taxpayer would have resulted in its having realized normal business profits. This case is thus different from *United States* v. *Cumberland Public Service Co.*, decided by this Court on January 9, 1950 (No. 214, October Term, 1949), where the corporation was being dissolved and where it distributed its assets to the stockholders in a liquidating dividend. Indeed, the opinion in the *Cumberland* case empha-

sizes the liquidation and dissolution of the corporate taxpayer, and expressly points out that (slip opinion, p. 4) "The corporate tax is thus aimed primarily at the profits of a going concern."[2] The Commissioner, as he is authorized to do under Section 45 of the Internal Revenue Code, *supra*, p. 3, could properly conclude that, with respect to these corporations, both owned by the same interests, the gain should be attributed to the taxpayer "* * * in order to prevent evasion of taxes or clearly to reflect the income * * *" of the subsidiary. The court below, relying on *Gregory* v. *Helvering,* 293 U. S. 465, upheld the Commissioner in deciding that the taxpayer could not avoid being taxed on its going concern business profits by the device of a dividend in kind to the parent, where this had no purpose except to avoid such taxation. While the taxpayer seeks to limit the *Gregory* case to its precise facts (Pet. 5, 13, 20-22), the contrary has been frequently held. *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609; *Griffiths* v. *Commissioner,* 308 U. S. 355; *Higgins* v. *Smith,* 308 U. S. 473.

In short, the court below has merely held that, in the circumstances of this case, the Tax Court plainly erred in holding that the dividend distribution must be viewed as genuine, and the sale of the stock as, in substance, one made not by the taxpayer

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[2] *Commissioner* v. *Court Holding Company,* 324 U.S. 331, also involved a liquidation and dissolution. In both cases, furthermore, the taxpayer's stockholders were individuals and not corporations.

but by its parent. There is no indication that the court took a view of *Commissioner* v. *Court Holding Company,* 324 U. S. 331, different from that recently expressed in the *Cumberland Public Service Co.* case,[3] and the issue, therefore, turns solely on an evaluation of the particular facts of this case. We suggest that the lower court, in reversing the Tax Court, no more went beyond the broader reviewing functions conferred on it by Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869, than it did in *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422, where, despite the narrower reviewing powers which then prevailed under *Dobson* v. *Commissioner,* 320 U. S. 489, the Second Circuit was sustained in reversing the Tax Court for having held that the income there in question was taxable to the parent rather than to the subsidiary.

4. Nor is there a conflict with *General Utilities Co.* v. *Helvering,* 296 U. S. 200 (Pet. 22-25). Although the taxpayer cites that case as having held that a corporation does not realize gain if it makes a dividend distribution in kind to its stockholders, there has been considerable confusion as to the precise holding of the case on that point, a confusion engendered by the cryptic remarks on that issue in

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[3] In *Fairfield S. S. Corp.* v. *Commissioner,* 157 F. 2d 321, 322 (see 5 T.C. 566, 576), certiorari denied, 329 U.S. 774, on which the opinion below relies (R. 40), the Second Circuit, also per L. Hand J., took a narrow view of the holding in favor of the Commissioner in *Court Holding.*

the opinion written by Justice McReynolds. But even if it be assumed that the taxpayer is correct in asserting that such was the decision of that case, it has no application here. The court below did not decide that the taxpayer realized taxable gain because it made a dividend distribution in kind to the parent. The taxpayer, instead, was held to have realized taxable gain because of the ultimate sale of the stock, and because the dividend distribution was merely a tax avoidance device which should be disregarded. It was not held taxable because it distributed the dividend; actually, it was held taxable despite the dividend distribution. The *General Utilities* case, which was not even mentioned by the court below, is not in conflict with its decision.

CONCLUSION

The decision below is correct. There is no conflict in decisions. Further review of this case would not be warranted. The petition for a writ of certiorari, accordingly, should be denied.

Respectfully submitted,

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Solicitor General.
THERON LAMAR CAUDLE,
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ELLIS N. SLACK,
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JANUARY, 1950.

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CHARLES ELMORE CROPLEY

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 505.

TRANSPORT, TRADING & TERMINAL CORPORATION,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR REHEARING OF PETITION FOR WRIT OF CERTIORARI.

ARTHUR A. BALLANTINE,
CHARLES C. MACLEAN, JR.,
Counsel for Petitioner.

Supreme Court of the United States

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To The Honorable, The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner hereby petitions for a rehearing of its petition for a writ of certiorari in the above-entitled cause which was denied by this Court on February 13, 1950, and in support thereof respectfully shows:

I. On December 29, 1949, petitioner filed its petition praying that a writ of certiorari be issued to the United States Court of Appeals for the Second Circuit to review a judgment of that Court rendered on October 4, 1949,

reversing a decision of The Tax Court of the United States that the petitioner had overpaid its Federal income taxes for the calendar year 1940. The Tax Court held that the petitioner, Transport, Trading & Terminal Corporation, realized no gain upon the distribution which it made of certain shares of Pacific-Atlantic Steamship Corporation as a dividend in kind to petitioner's parent, American-Hawaiian Steamship Company, either by reason of the distribution itself or by reason of the subsequent sale of such shares by American-Hawaiian.

On January 9, 1950, this Court handed down its decision in *United States* v. *Cumberland Public Service Company* (No. 214, October Term, 1949). That case, like this, arose because a stockholder of a corporation sold property received from the corporation, and in each case the Commissioner asserted a corporate tax liability on the theory that the distribution to the stockholder should be disregarded because made in order to save a tax. This theory, which was accepted unreservedly by the court below in the present case, was squarely rejected by this Court in the *Cumberland* case. Notwithstanding the clear conflict of the decision below with this Court's decision in the *Cumberland* case, this Court has denied certiorari here.

In his brief in opposition, the Commissioner attempted to distinguish this case from the *Cumberland* case solely on the ground that in the *Cumberland* case the distribution was made in liquidation, whereas in the present case the distribution was made by the petitioner, as the Commissioner states, "while it was actively engaged in business." Since the two cases are otherwise indistinguishable, it is submitted that this Court was influenced, erroneously, by the Commissioner's insistence that dividends in kind paid in order to facilitate an anticipated sale of the property,

unlike distributions in liquidation made for such purpose, result in a tax upon the distributing corporation.

Since the filing of the briefs herein, the fallacy of the Commissioner's contention has been made perfectly clear by the Treasury's recent request to Congress for a change in the statutory provisions governing the tax consequences of intercorporate dividends in kind. This request was made by the Secretary of the Treasury in the course of his appearance as Chief Fiscal Officer of the Nation before the Ways and Means Committee of the House on February 3, 1950. In his statement, the Secretary characterized the present tax treatment of such dividends of property intended to be sold as a "loophole" which

> "has in the past enabled many corporations desiring to sell property to avoid income tax upon such transaction by first distributing the property in kind to a parent company."*

In a supplemental statement submitted by the Secretary to the Committee as Exhibit 4, the Secretary said:

> "One of the more troublesome problems under existing law involves distributions in kind made by corporations to their shareholders. A striking loophole in this area is presented in cases where such distributions are made by a subsidiary to its parent company. *No gain or loss is recognized to the subsidiary in such cases;* and the parent company is allowed an intercorporate dividend credit equal to 85 percent of the market value of the property so received. Moreover, the parent company takes the property at a new basis equal to its market value at the time of the distribution." (Italics added.)

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* Statement of Secretary Snyder on 1950 Revenue Bill before the House Ways and Means Committee February 3, 1950 (Treasury Department Press Release No. S-2238, p. 18).

These statements show that the Treasury recognizes that, to date, Congress has not imposed any tax on a subsidiary distributing dividends in kind to its parent even where, as the Secretary states, the distribution is made in order "to avoid income tax" upon a prospective sale of the property distributed. Notwithstanding the decision below, the Treasury attached no qualification to the statements so made to the Ways and Means Committee. The Treasury did not suggest that the result is different where the dividend serves no "business purpose" or is not a "dividend" within the meaning of §115(a) I. R. C.—the absurdities contrived by the court below, which the respondent shunned in his brief to this Court.

The Treasury's proposal to Congress is that the 85% dividends received credit (§26(b) I. R. C.) available to a parent corporation receiving such a dividend, should be computed upon the basis of the property in the hands of the subsidiary, rather than upon the fair market value of the property received by the parent, so that, as the Secretary stated (Exhibit 4, p. 7):

> "upon receipt of the property by the parent corporation a full tax would be paid by the parent upon the increase in value of the property distributed."

The Treasury's recommendations provide the answer to respondent's attempt to differentiate this case from the *Cumberland* case on the ground that here the dividend was not a distribution in liquidation but was paid by a "going concern". In short, the Treasury has acknowledged that Congress has drawn the same line between (1) sales by a subsidiary corporation and (2) *dividends in kind* for the purpose of sale, that this Court found in the *Cumberland* case to exist between (1) sales by a corporation and (2) *distributions in kind* made in liquidation for the purpose of sale.

It is scarcely conceivable, therefore, that the Solicitor General would have opposed the petition in this case if he had known of the Treasury's position, so clearly stated by the Secretary before the Ways and Means Committee, that a subsidiary corporation incurs no tax by reason of a dividend in kind paid to its parent for the purpose of avoiding a tax on a prospective sale of the distributed property.

II. For the reasons shown above, this case is indistinguishable, *as a matter of law,* from the *Cumberland* case. The patent conflict between the two cases would seem to have required a grant of the writ here unless the ground of distinction attempted to be drawn by the Commissioner, discussed above, has misled the Court. Otherwise, it would seem that the writ could only have been denied because the Court was distracted from the legal issues by the Commissioner's emphasis on the fact that, three years before the dividend in kind was paid, the petitioner had acquired the shares which were the subject of the dividend in kind in a transaction in which petitioner's parent, American-Hawaiian, sustained a loss which was allowed for income tax purposes.

This wholly irrelevant circumstance has been stressed by the Commissioner throughout the entire history of this litigation, first in the Tax Court (R. 5), then before the Court of Appeals (Commissioner's brief, p. 19), and finally in the Commissioner's brief in opposition here, where he said (Br., p. 11):

> "On the undeniable facts of the case, the Commissioner was warranted in concluding that as between these two members of an inter-corporate family, the gain was realized by the subsidiary. It will be noted that this very block of stock in the Pacific-Atlantic Company had been the subject of an inter-company transfer which occurred only three

> years previously—a transaction whereby the parent sold the stock to the taxpayer for $20,000, and as a result of which it claimed and was allowed a capital loss deduction of $480,000 in its tax return for 1937. (R. 5) It was this same stock which was again sold in the taxable year for $582,285." (R. 10)

The Commissioner has never asserted that the loss allowed to petitioner's parent was improperly allowed; he has merely implied that there was something colorable or sham in the public auction sale at which petitioner purchased the shares from its parent. If the Commissioner had affirmatively stated that he had erred in allowing the loss to petitioner's parent, then the Commissioner's effort in this proceeding would have been disclosed to be what it has been in fact—an attempt to recoup for the Government, through imposing a tax upon the petitioner, a tax benefit which the Commissioner now considers should not have been allowed to American-Hawaiian.

If, therefore, the Court has been influenced to deny the writ here because of the 1937 loss allowed to American-Hawaiian, the real issue before this Court becomes whether the decision below, erroneous on its face, should be permitted to stand so as to enable the Government to recoup from this taxpayer the tax benefit assumed to have been improperly conferred upon its parent.

When the issue is so unmasked, the decisions of this Court leave no doubt as to what the answer should be. Essentially the same problem was considered in *McEachern* v. *Rose*, 302 U. S. 56 (1937), where this Court held that the Government was precluded from denying refunds of overpayments admittedly owing to the taxpayer through the device of crediting such overpayments against a tax liability, collection of which was barred by the statute of limi-

tations. The Court considered that denial of the refunds would be a clear violation of the statute, stating (pp. 59-60):

> "* * * But Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments of taxes because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him. Section 607 of the 1928 Act [§3770(a)(2) I. R. C.] declares that any payment of a tax after expiration of the period of limitation shall be considered an overpayment and directs that it be 'credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim'; and §609(a) of the 1928 Act [§3775(a) I R. C.] provides that 'Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.' *These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation.*" (Italics added.)

Clearly, therefore, under the statute, the tax liabilities of the current year are not to be influenced, much less determined, by the barred tax liability, if any, of a prior year. *A fortiori,* the tax consequences of a current transaction of the subsidiary should not be governed by a barred tax liability, if any, of its parent. Here, however, if the Court refuses to correct the decision below, solely because of the transaction of another taxpayer now closed by the statute of limitations, the Court will have sanctioned a clear violation of the Congressional design reflected in §§3770(a)(2) and 3775(a) of the Code.

The crude sort of recoupment which the Commissioner is attempting here was condemned by this Court in *Roth-*

ensies v. *Electric Storage Battery Co.*, 329 U. S. 296 (1946). In that case, this Court rejected the taxpayer's attempt to offset (under the doctrine of recoupment) the amount of certain illegally assessed excise taxes paid for the years 1919-1922, refund of which was barred, against the income tax liability attributable to refunds of illegally assessed excise taxes paid by the same taxpayer for the years 1922-1926. The sole basis of this Court's decision was that the attempted recoupment, if allowed, would undermine the statute of limitations. The Court said (pp. 301, 302, 303):

> "It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.
>
> • • • • • •
>
> "As statutes of limitation are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out. They tempt the equity-minded judge to seek for ways of relief in individual cases.
>
> "But if we should approve a doctrine of recoupment of the breadth here applied we would seriously undermine the statute of limitations in tax matters. * * *
>
> • • • • • •

> "We cannot approve such encroachments on the policy of the statute * * *."

If, because of the 1937 tax loss which is assumed but not asserted by the Commissioner to have been improperly allowed to American-Hawaiian, this Court declines to correct the erroneous decision of the court below imposing a tax on petitioner, then we respectfully submit this Court will have approved an encroachment on the policy of the statute of limitations far more flagrant than the encroachment which this Court so strongly condemned in the *Electric Storage* case.

III. On February 3, 1950, Secretary Snyder told the House Ways and Means Committee (p. 13):

> "We all know that the workability of our tax system and especially of the income tax depends on the high regard our people have for the fairness of our tax laws and their administration."

But if, at the same Term at which the Court granted review to the Government in the *Cumberland* case, this Court denies review to a taxpayer of a decision which is in square conflict with this Court's decision in the *Cumberland* case, then we submit, with all due respect, that such result will furnish a foundation for what some members of the public are already saying, viz., that whether this Court will review a tax case depends, not upon the importance or merit of the question presented, but upon whether the Government is the petitioner for review. Such a policy, we submit, would do much to shake the confidence of the people in the fairness of the administration of our tax laws.

For the foregoing reasons, it iis earnestly requested that a rehearing of the petition for ccertiorari herein should be granted.

Respectfully sulbmitted,

ARTHUR A. BALLANTINE,

CHARLES C. MACLEAN, JR.,
Counsel for Petitioner.

Certificate of Counsel.

We, ARTHUR A. BALLANTINE and CHARLES C. MACLEAN, JR., hereby certify, pursuant to Rule XXXIII(2), that the foregoing petition for rehearing iis presented in good faith and not for delay, and that the petition for rehearing is restricted to grounds of controlliing importance which have intervened since filing of the petition for writ of certiorari, and other substantial grounds available to petitioner but not previously presented.

ARTHUR A. BALLANTINE,

CHARLES C. MACLEAN, JR.